D.T.E. 00-73 **November 20, 2001**

Petition of Colonial Gas Company for the recovery of lost-based revenue associated with its demand-side management programs for the period May 1999 through April 2000.

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I. LBR RECOVERY FOR DSM MEASURES

A. Introduction

On September 15, 2000, Colonial Gas Company ("Colonial" or "Company")[1] filed with the Department of Telecommunications and Energy ("Department") a petition for recovery of $1,267,722 in lost base revenue ("LBR"), including carrying costs, associated with its demand-side management ("DSM") programs for the period May 1999 through April 2000. The Company states that the LBR is the result of the installation of DSM measures between October 1992 and April 2000. In its petition, the Company seeks to recover: (1) $550,587 in LBR for DSM measures installed during the period May 1996 through April 2000, as calculated using the rolling-period methodology adopted by the Department in Colonial Gas Company, D.T.E. 97-112 (1999); and (2) $717,135 in remaining LBR through an exogenous cost adjustment in accordance with the ten-year rate plan approved by the Department in Eastern-Colonial Acquisition, D.T.E. 98-128 (1999) ("Merger Order").[2]

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[1] On November 13, 2000, KeySpan Corporation, a registered public utility holding company with its principal offices located in New York, acquired Eastern Enterprises, the parent company of Colonial. As a result, Colonial is now operating as Colonial Gas Company d/b/a KeySpan Energy Delivery New England.

[2] On December 24, 1998, Eastern Enterprises and Colonial Gas Company ("Joint Petitioners") filed with the Department a petition requesting approval of (1) a merger of Colonial with Eastern and (2) a Rate Plan. One feature of the Rate Plan was the proposal to allow adjustments of base rates in connection with exogenous cost changes in excess of $140,000. The Joint Petitioners' proposed list of exogenous cost factors included items similar to those previously accepted by the Department, such as changes in tax laws, accounting changes, and regulatory, judicial, or legislative changes that uniquely affect the gas industry. Merger Order at 54, citing NIPSCO-Bay State Acquisition, D.T.E. 98-31 (1998); Eastern-Essex Acquisition, D.T.E. 98-27 (1998);

(continued…)

Pursuant to notice duly issued, the Department conducted a public hearing and procedural conference on November 16, 2000. The Attorney General and the Commonwealth's Division of Energy Resources ("DOER") intervened in the proceeding. Bay State Gas Company and Fitchburg Gas and Electric Light Company were granted limited participant status. The Department conducted a technical session on January 19, 2001 and an evidentiary hearing on February 8, 2001. The Company presented two witnesses at both the technical session and hearing: Ann Leary, Manager of Rates, and Jennifer Bedard of Business Market Planning.

According to the established schedule, the Attorney General filed an initial brief on February 28, 2001, and the Company filed its initial brief on March 14, 2001. The Attorney General submitted a reply brief on March 21, 2001, followed by the Company reply brief on March 28, 2001.

The evidentiary record consists of four Company exhibits, eight exhibits of the Attorney General, and three Department exhibits, as well as Company responses to two Attorney

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[2](…continued)

Boston Gas Company, D.P.U. 96-50 (Phase I) (1996). Additionally, the Joint Petitioners requested that changes in the Department's LBR-recovery policy also be treated as exogenous cost changes.

The Department issued its Merger Order on July 15, 1999, approving the proposed Rate Plan and finding that "a change in the Department's regulatory policy, including our LBR policy, that had cost consequences, would be encompassed under our definition of an 'exogenous cost.'" Merger Order at 55. The Department further found that the individual cost must exceed $250,000 in a particular year in order for the petitioners to request recovery of that particular exogenous cost increase. Id. at 56.

General record requests and two Department record requests. The records of Colonial's merger case, D.T.E. 98-128, and Colonial's rate unbundling proceeding, Colonial Gas Company, D.T.E. 98-64 (1998), were incorporated by reference (Tr. at 15, 38-39).

B. Standard of Review

In evaluating savings estimates for gas DSM programs, the Department will draw on its experience with electric DSM programs. Bay State Gas Company, D.P.U. 96-98, at 1 (1997). The Department has found that many estimates of savings that are not actually measured have been biased upward substantially, and has therefore required companies to measure savings using impact evaluations. Massachusetts Electric Company, D.P.U. 92-217-B, at 4-5 (1994) ("MECo"). The Department has identified and approved a wide variety of techniques for evaluating savings estimates. See id. at 7-16, 35-38, 47-51, 68-74. However, the Department has found many cases where appropriate techniques have not been applied or have been misapplied to produce savings estimates that are biased upward or downward. See id. at 5; Boston Edison Company, D.P.U. 96-1-CC, at 3-4, 9-12, 21-22, 24 (1996). Recognizing that obtaining more precise savings estimates has a cost, the Department directed companies to seek increased precision to the extent that the marginal value of more precise estimates exceeds the marginal cost of obtaining the additional precision. MECo at 5.

In MECo, the Department introduced a standard of review to be applied to impact evaluations.[3] The Department has used the same standard for gas DSM evaluations: in order

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[3] Impact evaluations use quantitative analyses to assess energy and capacity savings (continued...)

for a company's DSM savings estimates to be accepted, the company must demonstrate that its impact evaluations are reviewable, appropriate, and reliable. D.P.U. 96-98, at 2, citing MECo at 4-6. An impact evaluation is considered reviewable if it is complete, clearly presented, and contains a summary that sufficiently explains all assumptions and data presented. MECo at 4-6. An impact evaluation is considered appropriate if evaluation techniques selected are reasonable given the characteristics of a particular DSM program, the company's resources, and the available methods for determining demand and energy savings estimates. Id. Finally, an impact evaluation is considered reliable if the savings estimates included in the evaluation are unbiased and are measured to a sufficient level of precision, given the characteristics of a particular DSM program, the company's resources, and the available methods for determining demand and energy savings estimates. Id.

In Boston Gas Company, D.P.U. 94-15 (1995), the Department ordered local distribution companies ("LDCs"), when petitioning for the recovery of LBR and incentives from DSM programs, to develop energy savings estimates for their residential and multifamily

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[3](…continued)
resulting from the implementation of DSM programs. MECo at 1.

programs using the Gas Evaluation and Monitoring Study ("GEMS")[4] method,[5] subject to certain conditions. See D.P.U. 94-15, at 52-54.

C. The Company's DSM Impact Evaluations

1. Overview

In this proceeding, the Company submitted two LBR recovery filings for its Residential and Commercial & Industrial ("C&I") DSM Programs. For the first filing ("standard filing"), the Company calculated the LBR and associated carrying costs using the rolling-period methodology approved by the Department in D.T.E. 97-112. DSM measures installed by the Company before May 1, 1996 were not included in estimating total energy savings in the standard filing (see Exh. KSE-1). For the second filing ("exogenous cost filing"), Colonial calculated the total energy savings, the LBR, and associated carrying costs, based on the methodology approved by the Department prior to D.T.E. 97-112, and included all DSM measures installed by the Company between October 1992 and April 2000, with the exception of the measures already included in the standard filing (see Exh. KSE-2).

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4 GEMS was a comprehensive research project which used a variety of analytical tools to evaluate the effectiveness of residential and multi-family natural gas DSM programs. D.P.U. 94-15, at 1 n.1.

5 GEMS method refers to the overall analytical framework established by Boston Gas Company to: (1) determine the effectiveness of Boston Gas Company's residential DSM programs by estimating the amount of gross energy saved from a sample of its residential customers; (2) transfer these results to its residential DSM and non-host local distribution companies' DSM programs; and (3) adjust gross savings to account for factors that affect net program savings. Id., at 1 n.2.

Colonial requests the recovery of LBR and carrying costs associated with its Residential and C&I DSM programs of $1,267,722 for the period May 1999 through April 2000 (Exh. KSE-1, at 1). Colonial proposes to recover $550,587 pursuant to the rolling-period method approved by the Department in D.T.E. 97-112 and the remaining $717,135 as an exogenous cost pursuant to the ten-year rate plan approved in the Merger Order (id.). The Company proposes to recover each amount over a twelve-month period, the first period commencing November 1, 2000 (Exh. KSE-1, exh. 1, at 1; Exh. KSE-2, exh. 1, at 1).[6] The following sections break down this total amount by customer class.

2. Residential Programs

a. Description

In the standard filing, Exh. KSE-1, the Company calculated the LBR and associated carrying costs using the rolling-period methodology approved by the Department in D.T.E. 97-112. The Company did not include DSM measures that it installed before May 1, 1996 in estimating total energy savings in the standard filing. In the exogenous cost filing, Exh. KSE-2, Colonial calculated the total energy savings, the LBR, and associated carrying costs, based on the methodology prior to D.T.E. 97-112, and included all DSM measures installed by the Company before and after May 1, 1996, except the measures already included in the standard filing.

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6 The Department notes that the Company's local distribution adjustment factor ("LDAF") approved on October 31, 2000 includes all of the LBR and carrying costs proposed for recovery in this proceeding.

Colonial stated that it used the GEMS method, approved in D.P.U. 94-15, to calculate the savings per thousand cubic feet ("Mcf") for its residential DSM programs under both the standard filing and the exogenous cost filing (Exh. KSE-1, exh. 1, at 1). In the standard filing, Colonial estimated net energy savings for its residential DSM program of 62,197.60 Mcf for the period May 1999 through April 2000 (Exh. KSE-1, exhs. 6, 8). Based upon these estimates, the Company requests the recovery of $205,715 in LBR associated with its residential DSM program, plus carrying costs of $73,825, totaling $279,540 for the period May 1999 through April 2000 (Exh. KSE-1, exh. 1). In the exogenous cost filing, the Company estimated a net energy savings amount for its residential DSM program of 222,978.5 Mcf for the period May 1999 through April 2000 (Exh. KSE-2, exh. 2). Based upon these estimates, the Company requests the recovery of $523,415 in LBR associated with its Residential program, plus carrying costs of $20,442, or $543,857 in total (Exh. KSE-2, exh. 1, at 3).

b. Analysis and Findings

The Department has reviewed the Company's estimates of savings associated with its residential DSM programs. The Department notes that Colonial's method of calculating the residential program savings is the same as the method approved by the Department in Colonial Gas Company, D.T.E. 98-95/99-82 (2000) and D.T.E. 97-112. The Department finds that the Company appropriately applied the GEMS Method to calculate its energy savings estimates. Accordingly, the Department finds the Company's estimates of energy savings for its residential program to be reliable, reviewable, and appropriate, and hereby accepts them. Therefore, the

Department approves the recovery of LBR associated with the Company's residential DSM program of $205,715 plus carrying costs of $73,825 totaling $279,540 for the period May 1999 through April 2000. The Department will address the Company's request to recover LBR and associated carrying costs as an exogenous cost pursuant to the Merger Order in Section II, below.

3. C&I Programs

a. Description

As was the case with respect to its residential DSM programs, the Company submitted two LBR recovery filings for its C&I DSM Programs. In the standard filing, Exh. KSE-1, the Company calculated the LBR and associated carrying costs using the four-year rolling-period methodology approved by the Department in D.T.E. 97-112. The Company did not include DSM measures it installed before May 1, 1996 in estimating total energy savings in the standard filing. In the exogenous cost filing, Exh. KSE-2, Colonial calculated the total energy savings, the LBR, and associated carrying costs, based on the methodology used by the Department prior to D.T.E. 97-112, and included all DSM measures installed by the Company before and after May 1, 1996, except the measures already included in the standard filing.

In both filings, the Company stated that it used the impact evaluation process, the Mcf savings calculations, and lost margin and financial incentive calculations approved by the Department in Colonial Gas Company, D.P.U. 96-31 (1996) to calculate Mcf savings and lost margins for its Small and Medium C&I DSM programs (Exh. KSE-1, exh. 4, at 1). In the standard filing, Colonial estimated a net energy savings for its Small C&I program of 14,487.83 Mcf, and a gross energy savings amount for its Medium C&I program of 68,073.45 Mcf for the period May 1999 through April 2000 (Exh. KSE-1, exhs. 6, 8). Based upon these estimates, the Company requests the recovery of $227,076 in LBR associated with its C&I DSM program, plus carrying costs of $43,971, totaling $271,047 for the period May 1999 through April 2000 (Exh. KSE-1, exh. 9). In the exogenous cost filing, the Company estimated a net energy savings amount for its Small C&I program of 38,300.74 Mcf, and a gross energy savings amount for its Medium C&I program of 108,013.29 Mcf, for the period May 1999 through April 2000 (Exh. KSE-2, exhs. 6, 8). Based upon these estimates, the Company requests the recovery of $393,689 in LBR associated with its C&I DSM program, plus carrying costs of $50,636, or $444,325 in total (Exh. KSE-2, exh. 4, at 1).

The Company proposed to recover the LBR and associated carrying costs over a twelve-month period beginning November 1, 2000. As described below, Colonial used different methods to calculate energy savings of its Small and Medium C&I Programs.

b. Savings Estimates

i. Small C&I Program

Colonial's Small C&I Program consists of three steps: (1) Energy Assessment; (2) Installation of Selected Measures; and (3) Quality Control Inspection (Exh. KSE-1, exh. 4, at 2; Exh. KSE-2, exh. 4, at 2). The Company offered 13 gas savings measures to eligible customers (Exh. KSE-1, exh. 4, at 2; Exh. KSE-2, exh. 4, at 2). These customers included

Small C&I customers on rate classes G-41 and G-51 (Exh. KSE-1, exh. 4, at 2). Customers who participated in the program received full (100 percent) subsidy for installations of recommended measures (id.).

The Company indicated that in order to calculate net Mcf savings for each measure, it discounted the annualized gross savings figure for each measure by a free rider estimate and persistence factor (Exh. KSE-1, exh. 4, at 3). The Company defined free riders as those customers who planned to install a measure on their own (the same amount or more, sooner or at the same time) prior to program participation (id.). Colonial stated that persistence factors account for measures that are still installed and operating properly (id.). The Company explained that it developed these free rider estimates and persistence factors in D.P.U. 96-31 as part of the impact evaluation analysis (id.).

The Company's impact evaluation study indicated that the overall realization rate[7] for Small C&I Program is 107 percent, with a realization rate of 115 percent in the Lowell Division and 75 percent in the Cape Cod Division (Exh. KSE-1, exh. 4, at 2). Colonial explained the results to mean that gross savings estimated through the impact evaluation were 107 percent of the savings expected using the Company's engineering data for this program (id.). The Company further explained that, to calculate total program energy savings, it

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[7] A DSM tracking system contains estimates of the savings based on the original engineering estimate of savings for each measure. D.P.U. 96-98, at 4. An impact evaluation, on the other hand, estimates the amount of savings actually achieved. Id. The ratio of this latter estimate to the former tracking estimate is called a "realization rate." Id.

multiplied engineering savings estimates, or in this case technical potential savings estimates, for the entire population of program participants by the realization rate (id.).

Based on the four-year rolling-period method, the Company's total net Mcf savings attributable to the Small C&I Program for May 1999 through April 2000 amounted to 14,487.83 Mcf (11,901.82 Mcf in the Lowell Division and 2,586.01 Mcf in the Cape Cod Division) (Exh. KSE-1, exh. 6). Using the old methodology with which the Department calculated energy savings for all DSM measures installed before and after May 1, 1996, the Company's total net Mcf savings attributable to the Small C&I Program for the period May 1999 through April 2000 amounted to 38,300.74 Mcf (32,841.88 Mcf in the Lowell Division and 5,458.86 Mcf in the Cape Cod Division) (Exh. KSE-2, exh. 6). The Company used the total net monthly Mcf savings to calculate the LBR and associated carrying costs for its Small C&I Program for the Lowell and Cape Cod Divisions in both filings (Exh. KSE-1, exhs. 5, 6, 9).

ii. Medium C&I Program

The Company stated that customers on rate classes G-42 and G-52 were eligible for its Medium C&I Program (Exh. KSE-1, exh. 4, at 3). The Medium C&I Program involved five steps: (1) Energy Audit; (2) Evaluation of cost effectiveness measures and presentation of analysis; (3) Contractor quotes and selection; (4) Installation; and (5) Quality Control Inspection. The Company offers 27 gas savings measures through the Medium C&I Program (id.).

The method of calculating energy savings for the Medium C&I Program in the standard and exogenous cost filings was different from the engineering savings estimates method used for the Company's Small C&I Program. In calculating gross energy savings for its Medium C&I Program, the Company derived initial savings estimates by using customer-specific facility audit data (id.).[8] The Company stated that it used "Market Manager," an energy audit and modeling software package developed by Synergic Resource Corporation, to identify appropriate gas savings measures, and the associated cost and estimated savings for each customer (Exh. KSE-1, exh. 4, at 4). The Company further explained that for each customer, Market Manager created an energy model that simulated the energy use of a facility prior to the installation of any measure (id.). The Company then added savings measures to the model to estimate annualized Mcf savings for each customer (id.).

To calculate the gross annual Mcf savings for each program participant, the estimated gas usage for a facility as calculated by Market Manager with measure installation(s) was subtracted from the facility's existing gas usage as calculated by Market Manager (Exh. KSE-1, exh. 4, at 4-5). Additionally, Market Manager accounted for the necessary interaction, if any, between measures to arrive at final gross annual Mcf savings for each customer. By summing

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8 The Company stated that customer-specific facility audit data consist of Colonial's offer to each customer of an audit of the customer's facility under which an energy model is created to simulate the energy use of that customer's facility prior to installation of the program measure. Recommended program measures are then added to the model and estimated savings are calculated for each customer (Exh. KSE-1, exh. 4, at 4; Exh. KSE-2, exh. 4, at 4).

the gross annual Mcf savings over all program participants, the Company arrived at the total annual gross Mcf savings for its Medium C&I program (Exh. KSE-1, exhs. 7, 8).

The Company's filing showed that, based on the four-year rolling-period methodology, Colonial's total gross Mcf savings attributable to the Medium C&I Program for the period May 1999 through April 2000 amounted to 68,073.45 Mcf (48,348.55 Mcf in the Lowell Division and 19,724.90 Mcf in the Cape Cod Division) (Exh. KSE-1, exh. 8). Based on the old methodology which calculated energy savings for all DSM measures installed before and after May 1, 1996, the Company's total gross Mcf savings attributable to the Medium C&I Program for the period May 1999 through April 2000 amounted to 108,013.29 Mcf (76,277.92 Mcf in the Lowell Division and 31,735.37 Mcf in the Cape Cod Division) (Exh. KSE-2, exh. 8). The Company used these savings as input into its calculation of its LBR and associated carrying costs for the Medium C&I Program for the period May 1999 through April 2000 for both filings (Exh. KSE-1, exh. 9; Exh. KSE-2, exh. 9).

c. Analysis and Findings

The Department notes that, in this proceeding and for both filings, Colonial used the same evaluation methods previously approved in D.P.U. 96-31 and D.T.E. 97-112 to determine total energy savings for its Small and Medium C&I DSM programs. In accordance with D.T.E. 97-112, the Company's LBR calculations based on the four-year rolling-period method did not include energy savings associated with DSM measures installed before May 1, 1996. The LBR calculation in the exogenous cost filing, however, included DSM measures installed before and after May 1, 1996. The Department's review of the record shows that the

Company's impact evaluations for both the Small and Medium C&I Programs were complete and clearly presented, with all data and assumptions sufficiently explained. Accordingly, the Department finds that the Company's impact evaluations for its C&I DSM programs are reviewable. Furthermore, upon review of the record in this case, the Department finds that the evaluation techniques that Colonial used for its C&I programs are reasonable and are consistent with previous Department Orders. Therefore, we find that the Company's impact evaluations for its C&I programs are appropriate.

The Department notes that the energy savings estimates for Colonial's C&I programs are based on (1) engineering savings estimates multiplied by the realization rate for Small C&I customers, and (2) customer-specific Market Manager reports for Medium C&I customers. The Department further notes that Colonial used net Mcf savings estimates as input into the calculation of LBR and carrying costs for its Small C&I DSM program, but used gross Mcf savings estimates, rather than net Mcf savings estimates, as input into the calculation of LBR and carrying costs for its Medium C&I DSM program. Based on our review of the filings, we find that the net Mcf savings estimates reported by the Company for its Small C&I DSM program are sufficiently unbiased and are measured to a sufficient level of precision. We note that the gross Mcf savings estimates reported by the Company for its Medium C&I DSM program were calculated in accordance with the impact evaluation process approved by the Department in D.P.U. 96-31, D.T.E. 97-112 and D.T.E. 98-95/99-82, and are sufficiently reliable for the purposes of this case. However, gross Mcf savings could overestimate the net Mcf savings attributable to the Company's Medium C&I DSM program. Therefore, we direct the Company in its next LBR recovery filing to address the merits of calculating gross, versus net, savings for the Medium C&I DSM program.

On the whole, the Department finds that the Company's energy savings estimates for its C&I programs are reliable and were calculated in accordance with the methodology approved by the Department in D.P.U. 96-31. The Company's LBR in the standard filing was also calculated using the four-year rolling-period method approved by the Department in D.T.E. 97-112, at 33, and D.T.E. 98-95/99-82. Therefore, the Department approves the recovery of LBR associated with the Company's C&I DSM program of $227,076, plus carrying costs of $43,971, or $271,047 in total, for the period May 1999 through April 2000. The Department will address the Company's request to recover LBR and associated carrying costs as an exogenous cost pursuant to the merger plan approved in the Merger Order, in Section II below.

II. LBR RECOVERY THROUGH EXOGENOUS COST ADJUSTMENT

A. Introduction

In addition to the $550,587 LBR recoverable under the rolling-period methodology, Colonial seeks in its petition recovery of $717,135 in LBR through its Local Distribution Adjustment Clause ("LDAC") as an exogenous cost pursuant to the merger plan approved in the Merger Order. The $717,135 is comprised of $543,857 in LBR associated with its residential DSM program, and $173,278 in LBR associated with its C&I DSM program (Exh. KSE-2, exh. 1, at 3 and exh. 4, at 9).

B. Positions of the Parties

1. The Attorney General

The Attorney General argues that LBR through the year 2000 was incorporated into the determination of the Company's most recently approved rates as a result of the ten-year price freeze approved by the Department in the Company's merger filing in D.T.E. 98-128 (Attorney General Brief at 7). The Attorney General asserts that the recovery of the $717,135 in exogenous costs as well as the $550,587 in LBR would be inappropriate because the rate revenues the Department approved in the Company's rate freeze incorporated all LBR and were determined to be adequate for the Company to carry on its operations during the rate freeze period (id.). According to the Attorney General, any attempt by the Company to recover LBR would, therefore, be in defiance of the rate freeze (id.).

The Attorney General asserts that, in order to establish the cast-off revenue requirement in the Company's merger rate plan, Colonial used a test year of 1997 and rolled up certain costs through the year 2000 (Attorney General Brief at 7). Further, the Attorney General states that the Company made pro forma revenue adjustments to its 1997 test-year cost of service, removing its total LBR from its test-year revenue. According to the Attorney General, the Department accepted this adjustment and found the Company's rates to be adequate (id.). Therefore, the Attorney General concludes that since LBR for DSM programs was considered and given specific treatment by the Department in determining the cast-off revenue requirement and resulting merger savings, LBR cannot now be treated as an exogenous cost. Otherwise, the Attorney General contends, the Company will double collect on those costs (id. at 8).

The Attorney General further argues that Colonial's rates should be reduced to pass on to customers the benefits of cost reductions that arose as a result of an additional exogenous cost (id.). According to the Attorney General, the unbundling of rates by the Company pursuant to D.T.E. 98-64 shifted recovery of gas-related bad debt expenses from base rates to the CGAC, and, as a result, the Company profited from a $1.1 million reduction in cost (id.).

The Attorney General asserts that Colonial's $1.1 million windfall from the change in bad debt recovery is an exogenous cost as contemplated by the Department (id., citing D.P.U. 96-50, at 292 and Merger Order at 55). Therefore, the Attorney General concludes that the Department should allow the customers to benefit from this exogenous cost reduction through a corresponding decrease in the Company's rates (id. at 9).

2. The Company

The Company contends that the Department should grant LBR recovery, totaling $1,267,722 for the period May 1999 through April 2000, because $550,587 of this sum is correctly calculated using the rolling-period methodology for DSM recovery adopted by the Department in Colonial Gas Company, D.T.E. 97-112, and the remaining sum of $717,135 satisfies the Department's standard for the recovery of exogenous costs in accordance with the Rate Plan approved in D.T.E. 98-128 (Company Brief at 1-2). Colonial notes that in the Merger Order, the Department found that a change in the Department's regulatory policy, including LBR policy, that had cost consequences, could be encompassed under the definition of an exogenous cost, and then established an exogenous cost qualifying threshold of $250,000 for Colonial based on the relative magnitude of the Company's 1998 operating revenues (id.

at 7, 11). The Company argues, therefore, that it has satisfied the "Department's two-pronged standard" because: (1) the Company has incurred a cost consequence as a direct result of the Department's policy change in DSM calculation in D.T.E. 97-112 and (2) the exogenous cost of $717,135 is greater than the established threshold to qualify for recovery (id. at 12).

The Company asserts that there is no merit to the Attorney General's claim that LBR recovery should be denied because, through the year 2000, LBR was included in Colonial's most recently approved rates as a result of the merger and rate freeze approved in the Merger Order (id. at 13). The Company argues that the Attorney General misconstrues the nature of the Department's investigation in the merger case. Colonial maintains that there were no changes made to the Company's base rates or rate tariffs as a result of the merger case (id.). Colonial asserts that, prior to the Merger Order, the Company was collecting approximately $1.2 million in LBR costs via the LDAC, and that this amount was not adjusted in the merger proceeding. Colonial disputes the Attorney General's claim that the LBR amounts were included in the "revenue determination"[9] (Company Brief at 13-14).

The Company maintains that the purpose of the cost-of-service calculation was to measure merger-related savings by comparing the pre-merger cost of service with Colonial's post-merger cost of service after the rate freeze period concludes (id. at 15). Colonial contends that the analysis was not used as the basis for adjusting Colonial's rates, but rather to demonstrate some of the customer benefits of the merger and the subsequent rate freeze (id.).

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[9] Attorney General Initial Brief at 7.

Colonial maintains that the revenue requirement analysis was used solely as a means to illustrate the estimated savings that would ensue from a ten-year rate freeze and the accompanying avoidance of a base rate case. The Company explains that although it reduced the test-year operating revenues by the LBR amounts, this adjustment was purely for analytical use to denote the "zeroing out" of the LDAC that routinely accompanies a rate case. The Company argues that Colonial's actual base rates were not, in fact, adjusted at all (id. at 19).

Finally, the Company argues that the Attorney General is wrong in two respects in asking for a reduction in the Company's rates to recognize savings of $1.1 million resulting from a change in the accounting for bad debt expense in compliance with the Department's regulatory mandate to unbundle rates in D.T.E. 98-64[10] (Company Brief at 21). First, the Company argues that the Attorney General erred in asserting that the Department's decision to change the mechanism for recovering a portion of the Company's bad debt expense constitutes an exogenous cost change simply because the bad debt reduction was the result of a Department-ordered change for the gas industry in Massachusetts, and, therefore, it falls under the definition of "exogenous cost." The Company contends that the "regulatory change" to which the Attorney General alluded in his brief occurred well in advance of the merger and well before the rate freeze in D.T.E. 98-128. According to the Company, therefore, the Attorney General's argument concerning the change in bad debt accounting has no merit in this proceeding (id. at 21; Company Reply Brief at 2).

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[10] The record in D.T.E. 98-64 was incorporated by reference in this proceeding (Tr. at 38-39).

Second, the Company claims that to implement the rate unbundling mandated in D.T.E. 98-64, the Company removed gas-cost related, bad debt expense of $1,399,073 ($419,667 and $979,406 for the Cape and Lowell Divisions, respectively) from its base rates and shifted the expense to its CGAC for recovery. Therefore, the Company contends that no further adjustment is needed or appropriate (Company Brief at 22; Company Reply Brief at 2). Accordingly, the Company asks that the Department reject the Attorney General's request that rates be reduced to reflect a negative cost adjustment relating to the removal of bad debt expense from base rates (id.).

C. Standard of Review

The Department will evaluate the Company's ability to recover LBR through an exogenous cost adjustment in part based on its determinations concerning the requirements for exogenous cost recovery in previous Orders. Merger Order, D.T.E. 98-128 (1999); NIPSCO-Bay State Acquisition, D.T.E. 98-31 (1998); Eastern-Essex Acquisition, D.T.E. 98-27 (1998); Boston Gas Company, D.P.U. 96-50 (Phase I) (1996).

The Department has defined exogenous costs as positive or negative cost changes beyond a company's control that would significantly affect the company's operations. Merger Order at 54; NIPSCO-Bay State Acquisition at 17, Eastern-Essex Acquisition at 19. Included in that definition are cost changes resulting from: changes in tax laws that uniquely affect the local gas distribution industry; accounting changes unique to the local gas distribution industry; and regulatory, judicial or legislative changes uniquely affecting the local gas distribution industry. D.P.U.96-50 (Phase I) at 292; NIPSCO-Bay State Acquisition at 17, Eastern-Essex Acquisition at 19. In the Merger Order at 55, the Department accepted the Company's proposal that for Colonial, a change in our regulatory policy regarding LBR, that had cost consequences, be deemed an exogenous cost eligible for proposed recovery.

Further, to avoid costly regulatory process over minimal dollars, the Department has stated that cost changes must meet a monetary threshold, based on a company's size, for qualification to be proposed as an exogenous cost. Merger Order at 55; NIPSCO-Bay State Acquisition at 18; D.P.U. 96-50 (Phase I) at 293. The Department established thresholds on a company-specific basis to reflect a "principle of proportionality" in relation to the company's operating revenues. Merger Order at 55-56. The Department determined that any individual exogenous cost must exceed the Company's threshold in a particular year in order for the Petitioners to request recovery of that particular exogenous cost increase. Id. at 55-56; NIPSCO-Bay State Acquisition at 18; D.P.U. 96-50 (Phase I) at 293. In Colonial's case, the Department established a monetary threshold of $250,000. Merger Order at 56. To recover exogenous costs during a rate plan, Petitioners are required to propose exogenous cost adjustments, with supporting documentation and rationale, to the Department for determination as to the appropriateness of recovery of the proposed exogenous costs. Id. at 55; NIPSCO-Bay State Acquisition at 17-18.

The Department also has indicated that for rate plans approved pursuant to the merger filings that are not performance base regulation ("PBR") plans, there will be no change to the traditional cost of service regulation by which the Department currently regulates the rates of the companies. Merger Order at 16. Accordingly, during the duration of each rate plan, the earnings of the companies will be a factor in consideration of whether the Department will approve a request for recovery of an exogenous cost. Based on the foregoing, proponents of an exogenous cost adjustment bear the burden of demonstrating: (1) that the cost change is of a type that is external to the company and is "beyond the company's control"; (2) that the magnitude of the cost change is such so as to significantly affect the company's operations; and (3) that the company's earnings, independent of recovering a proposed exogenous cost, are reasonable.

D. Analysis and Findings

We first address the issue of whether the Company has met the Department's three-pronged test for the recovery of a portion of LBR as exogenous costs. We then address the Attorney General's claim that (1) any recovery of LBR would be a "double collection" and (2) that the Company's base rates be reduced to account for a change in accounting procedures with regard to the treatment of bad debt expense in the Company's rate unbundling proceeding in D.T.E. 98-64.

As we stated above, the Company seeks to recover $717,135 of LBR as an exogenous cost adjustment. This amount represents the annual impact of the Department's change in regulatory policy in D.T.E. 97-112.[11] In the Merger Order at 55, the Department stated that, for Colonial, "a change in our LBR policy that had cost consequences would be encompassed under our definition of exogenous costs." The Department in that case also established for Colonial a monetary threshold of $250,000. Id. at 56. The record in this case shows that the cost impact of the change in regulatory policy is $717,135, which exceeds the threshold established by the Department in the merger case. Therefore, we find that the Company has met the first two of the Department's conditions for proposed recovery of exogenous costs. That is, the cost change is of a type that is external to the Company and the magnitude of the cost change exceeds the established monetary threshold.

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11 This amount is the difference between the total LBR amount of $1,267,722 and the LBR amount of $550,587 calculated based on the Department's rolling-period method (Exh. KSE-1; Exh. KSE-2; Exh. KSE-3).

The question remains as to whether the Company's earnings were such that they would not warrant recovery of the $717,135 in LBR. The record shows that the Company's 1999 return on equity ("ROE") was 5.21 percent (RR-DTE-2). Colonial's ROE for year 2000 was 2.78 percent (RR-DTE-2 Supp.).[12] These returns are significantly lower than the ROE allowed by the Department for LDCs in the most recently litigated rate cases. See Fitchburg Gas and Electric Light Company, D.T.E. 98-51, at 127 (1998); D.P.U. 96-50 (Phase I) at 133. Further, the Company has already recovered, subject to refund, the LBR amount in question. Consequently, a rejection of the Company's proposal would further reduce Colonial's earned ROE. The Department concludes that the level of Colonial's earnings for 1999-2000 do not warrant rejection of the Company's petition for recovery of the $717,135 in LBR. Therefore, we find that the Colonial has met the third condition of the Department's three-pronged test for proposed recovery of exogenous costs. Accordingly, the Department will allow recovery of the LBR as an exogenous cost in this case.

We now turn to the Attorney General's arguments. First, the Attorney General asserts that the Department should deny Colonial recovery of LBR because the rate revenues approved by the Department in Colonial's most recent rate freeze in the Merger Order already incorporated all LBR and were deemed adequate for the Company's operations.

We disagree. At the time of the merger filing, the Company was collecting its LBR through the LDAC and we made no adjustment during the merger proceeding to eliminate the

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[12] We note that these ROEs are based on a net income amount that includes the add back of amortization of the acquisition premium. See RR-DTE-2

recovery of LBR or to provide for recovery through base rates. The Department made no changes to the Company's base rates in the Merger Order. Rather, the Department approved a Rate Plan that (1) froze base rates for a ten-year period and (2) provided customers with an estimated 2.2 percent reduction in total burner-tip gas prices for firm sales customers. The Department indicated that the "proposed Rate Plan, submitted as part of the merger proposal, is not a rate case with a traditional historic test year." Merger Order at 19. The revenue requirement analysis in the Merger Order was "not used to determine how much the Company prospectively can collect from ratepayers." Id. Instead, the revenue requirement analysis was simply a tracking mechanism used to measure (1) the savings associated with the avoidance of a rate case over the ten years, and (2) what Colonial's revenue requirement would be at the end of year ten of the rate freeze, had Colonial operated during that time on a stand-alone basis. Id. at 16, 19. In approving the proposed Rate Plan, the Department did not change the Company's rates as a result of the revenue requirements analysis, and, therefore, LBR was not incorporated into Colonial's rates. Accordingly, we reject the Attorney General's argument that recovery of LBR as an exogenous cost in this proceeding would lead to double-collection by the Company.

With respect to the Attorney General's argument that the Company's rates should be reduced because the removal of bad debt expense qualifies as an exogenous change resulting from the Department-ordered unbundling of rates, we find that his claim is without merit. The shifting of some bad-debt-related costs to the CGAC cannot be considered an exogenous cost because the Department approved the Company's rate unbundling proposal before Colonial filed its merger and Rate Plan, not after, as the Attorney General contends.

By letter dated August 18, 1997, the Department directed the Company, along with four other investor-owned LDCs, to fully unbundle its rate tariffs and submit them to the Department no later than November 1, 1998. On August 14, 1998, the Department approved Colonial's revenue-neutral, unbundled rate settlement in D.T.E. 98-64. On September 16, 1998, the Company filed new rate schedules with the Department, which became effective November 1, 1998, in accordance with the provisions of D.T.E. 98-64. The proposed merger and Rate Plan were submitted to the Department on December 24, 1998, subsequent to approval of the unbundled rates.

Moreover, the record shows that in D.T.E. 98-64, Colonial's base rates were reduced by the same amount of the bad debt expense for which recovery was shifted to the CGAC. In particular, in its rate unbundling proposal, the Company's test-year cost of service included total bad debt expense of $1,399,073 ($419,667 and $979,406 for the Cape Cod and Lowell Divisions, respectively). In determining the total gas-related bad debt expense, the Company multiplied the total bad debt expense by the ratio of test-year gas costs revenue divided by the test-year total revenue requirement. After adding associated working capital costs, a total of $729,554 ($209,844 for Cape Cod Division and $519,710 for the Lowell Divisions) of gas-related bad debt expense was removed from the fully-allocated net base revenues for recovery via the CGAC. See D.T.E. 98-64 Explanatory Statement at 3 ("Explanatory Statement"). Thus, the Company's base rates were reduced by this same amount, $729,554 ($209,844 for the Cape Cod Division and $519,710 for the Lowell Division). The Department finds that no further adjustment to the Company's base rates is appropriate or necessary. We therefore reject the Attorney General's request that the Company's base rates be reduced to recognize the Department's regulatory mandate to unbundle rates. Accordingly, for all the reasons stated above, the Department approves the Company's request to recover $717,135 as an exogenous cost.

III. ORDER

Accordingly, after due notice, hearing and consideration, it is

ORDERED: That the savings estimates for Colonial's DSM measure installations for the period May 1999 though April 2000 are hereby approved; and it is

FURTHER ORDERED: That the Company shall show separate calculations of Lost Margins and associated carrying costs for its Small C&I Program and its Medium C&I Program for both the Cape Cod and Lowell Divisions; and it is

FURTHER ORDERED: That the Company shall use net Mcf savings in calculating LBR and associated carrying costs for both its Small and Medium C&I Programs; and it is

FURTHER ORDERED: That the Company shall recover total lost base revenues of $1,267,722 associated with its demand-side management programs for the period May 1999 through April 2000.

By Order of the Department,

James Connelly, Chairman

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).